IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL No. 144 of 2001
With
TAX APPEAL No. 19 of 2002
With
TAX APPEAL No. 238 of 2002
With
TAX APPEAL No. 290 of 2002
With
TAX APPEAL No. 291 of 2002
With
TAX APPEAL No. 169 of 2003
With
TAX APPEAL No. 385 of 2003
With
TAX APPEAL No. 386 of 2003
With
TAX APPEAL No. 244 of 2006

For Approval and Signature:

HONOURABLE MR.JUSTICE K.A.PUJ
HONOURABLE MR.JUSTICE R.H.SHUKLA

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1	Whether Reporters of Local Papers may be allowed to see the judgment ?
2	To be referred to the Reporter or not ?
3	Whether their Lordships wish to see the fair copy of the judgment ?
4	Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?
5	Whether it is to be circulated to the civil judge ?

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ELECON ENGINEERING CO. LTD. - Appellant(s)
Versus
A.C.I.T. - Opponent(s)

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Appearance :
MR RK PATEL for Appellant(s) : 1,
MR KM PARIKH for Opponent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE K.A.PUJ

and

HONOURABLE MR.JUSTICE R.H.SHUKLA

Date : 21/07/2008

COMMON ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE K.A.PUJ)

1. Since common issue is involved in all these Tax Appeals and since all these Tax Appeals are in the same assessee's case, namely, Elecon Engineering Co. Ltd., for the assessment years 1986-87 to 1994-95 they are being disposed of by this common judgment and order.

2. At the instance of the assessee, following substantial questions of law were formulated for the assessment year 1986/87, which is the first assessment year in point of time, for the consideration and determination of this Court:-

(i) Whether on the facts and in the circumstances of the case, the Tribunal

has substantially erred in law in ignoring the ratio of binding decision of Supreme Court in the case of AKKAMAMBA TEXTILE LTD. and SIVAKAMI MILLS LTD. at 227 ITR 464 and 465 ?

(ii) Whether on the facts and in the circumstances of the case the Tribunal has substantially erred in law in ignoring the ratio of binding decision of Supreme Court in the case of INDIA CEMENTS LTD. at 60 ITR 52 ?

(iii) Whether on the facts and in the circumstances of the case the Tribunal is right in law in its interpretation of provisions of section 36(1)(iii), Section 37(1) and Section 43A of the Income-tax Act, 1961 read alongwith Exchange Control Rules.

3. However, in Tax Appeal No.19/2002 for

assessment year 1987-88 the Court has reformulated the substantial question of law as under:-

> "(i) Whether on the facts and in the circumstances of the case the Tribunal is right in law in its interpretation of provisions of Section 36(1)(iii), Section 37(i) and Section 43A of the Income-Tax Act, 1961 read alongwith Exchange Control Rules ?"

4. The brief facts giving rise to all these Tax Appeals are that the appellant/assessee is a Company in which public are substantially interested. The appellant is being regularly assessed by the Income-Tax Department since years at Vadodara. The appellant has filed its return of income for respective assessment years and assessments were made after several additions and disallowances by passing final assessment orders under Section 143(3) of the Income-Tax

Act, 1961. Amongst various disallowances made by the Assessing Officer, one of the disallowances which was challenged before the appellate authorities pertains to disallowance out of insurance expenses claimed by the appellant. The following insurance expenses are paid by the appellant to Citi Bank for roll over premium in respect of foreign exchange forward contracts, are claimed by the appellant for the respective years.

Sr.No.	Tax Appeal No.	Assessment years	Amount
1	144/2001	1986-87	Rs.8,86,280
2	19/2002	1987-88	Rs.29,95,799
3	238/2002	1988-89	Rs.56,45,676
4	291/2002	1989-90	Rs.1,62,63,936
5	290/2002	1990-91	Rs.1,45,33,276
6	385/2003	1991-92	Rs.63,86,710
7	169/2003	1992-93	Rs.47,30,414
8	386/2003	1993-94	Rs.26,84,790
9	244/2006	1994-95	Rs.1,31,770/-

5. The Assessing Officer disallowed the same by stating that the expenditure is in connection with purchase of plant and

machinery and the same is in the nature of capital expenditure.

6. Being aggrieved by the said disallowance the appellant preferred Appeals for the respective years before the learned CIT (Appeals). The learned CIT(Appeals) gave a factual finding that the amount is paid by way of premium to cover the exchange fluctuation risk and allowed the expenditure as revenue expenditure as claimed by the appellant.

7. Being aggrieved by the order of the learned learned CIT (Appeals), the Revenue preferred Appeal before the Tribunal. The Tribunal has considered the submissions of the assessee and the Revenue and the provisions contained in Section 36(1)(iii) read alongwith Section 43A of the Income-tax Act, 1961 and concluded the issue against the assessee by reversing the decision of CIT (Appeals) by stating that

looking to the nature of expenses and provisions of Section 43A, the Assessing Officer is legally and factually correct in capitalising the roll over charges.

8. For all subsequent years the Tribunal has followed its own order passed for assessment year 1986-87.

9. It is in the above context, all these Appeals were filed by the appellant/assessee raising substantial questions of law as indicated above.

10. Mr.R.K.Patel learned advocate appearing for the appellant assessee in all these Appeals has submitted that the appellant Company has obtained loans in foreign currency not for the purpose of acquiring fixed assets for the purpose of establishing new plant but for modernization and expansion of the existing business. Since the

repayment of these loans was stipulated in installments the appellant company desired to ensure that the foreign currency required for payment of the loans be obtained at a predetermined rate and cost. Hence the company had booked forward contracts for delivery of the required foreign currencies on the stipulated dates. The contract was entered into for the entire outstanding amount and delivery of foreign currency obtained under the contract for the installment due from time to time. The balance value of the contracts, after deducting the amount withdrawn towards repayment, was rolled over for a further period upto the date of next installment. As per the exchange control rules forward cover is available for a maximum period of 6 months and, hence, to cover long term loans the company was required to roll over and carry forward, the unutilised forward over. Roll over charges/carry forward charges, are

required to be paid to the authorised dealer as consideration for permitting the unutilised amount of the contract to be availed at a later date. He has further submitted that the roll over premium was paid to mitigate the risk involved in higher payment because of adverse fluctuation of rate of exchange. It is now settled law that any expenditure incurred for raising loans is on revenue account. He relied on decision of the Apex Court in the case of **India Cement Ltd. Vs. CIT 60 ITR 52**, wherein it is held that a loan by itself is not a capital asset and that any expenditure incurred in connection therewtih can be treated as on revenue account. He has, therefore, submitted that when the appellant company is allowed interest on such borrowings, no question of disallowance of premium paid to cover exchange risk would arise. The premiums were paid as a principle of business expediency and on commercial grounds having

no connection at all with the question of acquisition of machinery. He has, therefore, submitted that the premium paid on forward contracts is an allowable deduction and accordingly such premium amount is required to be allowed.

11. Mr.Patel has further submitted that Section 43A was invoked for the first time before the Tribunal. Under Section (1) of Section 43A, while determining the cost to the assessee of the machinery, except for ascertaining whether and to what extent the cost has been met directly or indirectly by any other person or authority, the Assessing Officer cannot go into the question as to how the assessee got the currency for paying the price of the machinery and at what rate he got it. Sub Section (1) of Section 43A restricts the scope and effect of devaluation to determine the cost of acquisition of a capital asset, not being a capital asset

referred to in Section 50, for the purpose of Section 48. Section 50 deals with a capital asset in respect of which a deduction on account of depreciation has been obtained by the assessee in any previous years in computing 'Capital gains' arising on the sale or transfer of a capital asset acquired from abroad, on deferred payment terms or against a foreign loan, additional rupee liability will be added to the original cost of the asset. If, however, the rupee liability is a decrease, instead of an increase, then, the original cost will be correspondingly reduced. He has, therefore, submitted that except for this purpose Section 43A has no application.

12. He has further submitted that the appellant/assessee has claimed the expenses in question either under Section 36(1)(iii) or under Section 37 of the Act. In support of his submission he relied on the decisions

of the Apex Court in the case of **Additional Commissioner of Income-tax Vs. Akkamamba Textiles Ltd.** and **Commissioner of Income-Tax Vs. Sivakami Mills Ltd., reported in 227 ITR 464 and 465** respectively. The Apex Court in these two cases held that guarantee commission paid to banker and insurance Company for ensuring deferred payment of purchase consideration of machinery was admissible deduction under Section 37 of the Income-Tax Act, 1961.

13. Mr.Patel further relied on the decision of the Apex Court in the case of **Commissioner of Income-Tax Vs. Tata Iron and Steel Co.Ltd., 231 ITR 285**, in which case at the time of repayment of loan there was fluctuation in the rate of foreign exchange as a result of which, the assessee had to repay a much lesser amount than he would have otherwise paid. The Court held that this was not a

factor which could alter the cost incurred by the assessee for purchase of the asset. The assessee might have raised the funds to purchase the asset by borrowing but what the assessee had paid for it, was the price of the asset. That price could not change by any event subsequent to the acquisition of the asset. The manner or mode of repayment of the loan had nothing to do with the cost of an asset acquired by the assessee for the purpose of his business.

14. Mr.Patel further relied on the decision of Apex Court in the case of **Dy. Commissioner of Income-Tax Vs. Core Health Care Ltd. reported in 298 ITR 194**, wherein it is held that Section 36(1)(iii) of the Income-tax Act, 1961 has to be read on its own terms. It is a code by itself. It makes no distinction between money borrowed to acquire a capital asset or a revenue asset. All that the section requires is that the assessee must

borrow capital and the purpose of the borrowing must be for business which is carried on by the assessee in the year of account. Unlike Section 37 which expressly excludes an expense of a capital nature, Section 36(1)(iii) emphasises the user of the capital and not the user of the asset which comes into existence as a result of the borrowed capital. The legislature has, therefore, made no distinction in Section 36(1)(iii) between 'capital borrowed for a revenue purpose' and 'capital borrowed for a capital purpose'. An assessee is entitled to claim interest paid on borrowed capital provided that the capital is used for business purpose irrespective of what may be the result of using the capital which the assessee has borrowed. 'Actual cost' of an asset has no relevancy in relation to Section 36(1)(iii).

15. Mr.Patel further relied on the decision of

the Apex Court in the case of **Dy. Commissioner of Income-Tax Vs. Gujarat Alkalies and Chemicals Ltd., reported in (2008) 299 ITR 85**, wherein the finance charges paid by the assessee to COFACE on the foreign currency were treated by the revenue in the nature of interest and commitment charges and following its own decisions in Dy.CIT vs. Core Health Care Ltd., (Supra) as well as Akkamamba Textile Ltd. and Sivakami Mills Ltd., the Apex Court decided the matter in favour of the assessee and against the revenue.

16. Mr.Patel, therefore, submitted that the roll over charges are nothing but the commitment charges or in the nature of interest and hence the said expenses are admissible either under Section 36(1)(iii) or under Section 37 of the Act. He has, therefore, submitted that the questions formulated for the determination and

consideration of this Court are answered in favour of the assessee and against the revenue.

17. Mr. K.M.Parikh, learned Standing Counsel appearing for the Revenue on the other hand has submitted that the judgments cited and relied upon by the assessee are clearly distinguishable as they relate to deductibility of deduction claimed under Section 36(1)(iii) which does not draw any distinction between capital and revenue outlay. He has submitted that in view of the Explanation-3 of Section 43A, roll over charges paid are to be capitalised within the meaning of Section 43A of the I.T.Act, 1961. He has submitted that Section 43A(1) opens with a non obstante clause, namely, “notwithstanding anything contained in any other provisions of this Act”, therefore Section 43A(1) over-rides any other provisions contained in 1961 Act including

provisions of Section 36(1)(iii) of I.T.Act, 1961. He has submitted that the appellant/assessee desired to ensure that the foreign currency required for repayment of the loans be obtained at a pre-determined rate and cost. Accordingly, the assessee company has booked forward contract with Citi Bank N.A. for delivery of the required foreign currency on the stipulated dates. The contract was entered into for entire outstanding amount and delivery of foreign currency obtained under the contract for the installment due from time to time. The balance value of the contracts, after deducting the amount withdrawn towards repayment, was rolled over for a period upto the date of next installment. As per the exchange control rules forward cover was available for a maximum period of six months and, therefore, to cover long term loans the assessee company was required to roll over/ carry forward, the unutilised forward cover.

Roll over charges/carry forward charges, were required to be paid to the authorised dealer as consideration for permitting the unutilised amount of the contract to be availed at a later date. He has submitted that looking to the nature of expenses and provisions of Section 43A of the Act, the Assessing Officer is legally and factually correct in capitalising the roll over charges. He has, therefore, submitted that the Tribunal has rightly decided the issue in favour of the Revenue and against the assessee and no interference is called for in the order of the Tribunal. He has further submitted that Section 43A was not under consideration in any of the decision of the Apex Court cited and relied upon by the assessee. He has, therefore, submitted that all these Appeals are required to be dismissed.

18. Having considered the rival submissions

and the relevant statutory provisions contained in Section 36(1)(iii), 37(1) and 43A read with Explanation-3 thereto and the authorities cited before the Court, we are of the view that the roll over charges paid by the appellant/assessee to Citi Bank are nothing but the interest or committal charges and as per the decision of the Apex Court in the case of Dy.CIT vs. Core Health Care Ltd. and Dy. CIT Vs. Gujarat Alkalies and Chemicals Ltd. (Supra), the same are allowable under Section 36(1)(iii) of the Act. There is no dispute about the fact that the amount borrowed is used for business purpose. There is also no dispute about the fact that the amount paid by way of roll over charges is in relation to the amount borrowed. The actual cost on asset has no relevancy into Section 36(1)(iii) of the Act. The Apex Court has categorically held that the legislature has not made any distinction in Section 36(1)(iii) between 'capital

borrowed for revenue purpose' and 'capital borrowed for capital purpose'. Under Section 36(1)(iii), the only requirement is that the assessee must borrow capital and purpose of borrowing must be for business which is carried on by the assessee in the year of account. Both these conditions are satisfied in the case of assessee. The amount was borrowed for modernization of the existing plant and business was carried on by the assessee during all these years. The balance value of the contracts after deducting the amount withdrawn towards repayment was rolled over for a further period upto the date of next installment. Thus, roll over premium was paid to mitigate the risk involved in possible higher payment due to adverse fluctuation of the rate of exchange. Thus, the nature of expenditure involved was for the business purpose of raising loans on revenue account. The Revenue has disallowed assessee's claim despite the fact that the

interest on such borrowing was allowed by the Assessing Officer. Before the Tribunal, the disallowance was sought to be justified only on the ground of applicability of Section 43A read with Explanation-3 thereto. However, the scope and ambit of the said Explanation-3 is very limited and such charges will be added to the actual cost only in the limited circumstances envisaged in the said section. It cannot be added to the actual cost or it is not required to be capitalised when it has nothing to do with the actual cost. We are, therefore, of the view that the Tribunal has committed an error in disallowing the roll over expenses claimed by the assessee during all these years. The Tribunal's orders are, therefore, required to be reversed and the claim of the assessee in all these years is required to be allowed. Accordingly, we hold that the assessee is entitled to deduction of roll over charges under Section 36(1)(iii) of the I.T.Act, 1961.

19. All these Appeals are accordingly allowed without any order as to costs.

20. Office is directed to place copy of this order in each of these Tax Appeals.

(K. A. PUJ, J.) (R. H. SHUKLA, J.)

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